



# MACROECONOMIC ANALYSIS OF MONGOLIA

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## CONTENTS

DYNAMICS OF MONGOLIAN MACROECONOMICS IN THE LAST THREE YEARS .....	5
1. Special occasion of 2006 .....	5
2. 2009 crisis outlook.....	6
3. Macroeconomic changes in 2006-2009 .....	7
3.1. General index of prices for consumer goods.....	7
3.2. Currency rate .....	10
3.3. Salaries, wages, pensions and benefits .....	12
3.4. Money, loans.....	14
3.5. Foreign trade, prices .....	19
3.6. Some production dynamics.....	23
4. Third quarter of 2009 .....	24
5. Conclusions and lessons from the last three years.....	27

*The present study on “Dynamics of the Mongolian macroeconomics in the last three years (III quarter of 2006-III quarter of 2009)” was implemented in the frame of work on development of “A short- and mid-term macroeconomic computer model of Mongolia” on commission of the Open Society Forum of Mongolia in the course of the study to determine interdependence and correlation of variables and parameters.*

*The study used all issues of the monthly bulletin published by the National Statistics Committee from the first half of 2006 to the third quarter of 2007.*

# DYNAMICS OF MONGOLIAN MACROECONOMICS IN THE LAST THREE YEARS

## 1. SPECIAL OCCASION OF 2006

In 2006 the Mongolian economy for the first time in the last fifty years showed a balance and

positive dynamics of macroeconomic indicators. These specifics are shown in table 1.

**Table 1**

No	Indicators	2006
NN	1	2
1	GDP growth (compared to the previous year) %	+8.6
2	Inflation rate %	+6.0
3	Foreign trade balance	
	- Million US dollars	+57.2
	- Share in export	+3.7
4	Share of budget expenditure in GDP -%	36.5
5	Budget balance	
	- Million MNT	+6.3
	- Share in income	+0.4
6	Ratio of total money to GDP	41.3
7	Currency rate (1 US dollar = tugrug)	
	Changes – MNT	-56.0
	Percentage of changes	-4.6
8	Changes in the percentage of non-performing loans in total loans - %	-0.76
9	Percentage of total loans outstanding in total money - %	79.6
10.	Ratio of bank reserves to total loans outstanding- %	15.5
	Less government reserves	6.3

The above indicators illustrate that in 2006 the national economy reached a favorable balance and obtained

an ability to maintain its stable dynamics under good regulation.

## 2. 2009 CRISIS OUTLOOK

In three years since 2006 the main economic indicators of our country have declined sharply

and lost their positive balance and dynamics. Table 2 shows them in the first half of year 2009.

**Table 2**

No	Indicators	First half of 2009
NN	1	2
1	GDP growth (compared to the previous year) %	-5.5
2	Inflation rate %	+7.3%
3	Foreign trade balance	
	- Million US dollars	-131.9
	- Share in export	-17.3
4	Share of budget expenditure in GDP -%	58.6
5	Budget balance	
	- Million MNT	-261.3
	- Share in income	-31.6
6	Ratio of total money to GDP - %	39.2
7	Currency rate (1 US dollar = tugrug)	
	Changes – MNT	1435
	Percentage of changes	+24.0
8	Percentage of non-performing loans in total loans outstanding - %	11.6
9	Percentage of total loans outstanding in total money - %	105.5
10.	Ratio of bank reserves to total loans outstanding - %	18.2
11.	Ratio of bank reserves less government savings to total loans outstanding - %	-2.9

The above indicators illustrate that the national economy lost its balance and plunged into acute crisis.

### 3. MACROECONOMIC CHANGES IN 2006-2009

The economic recession that became obvious in the second half of 2008 and reached its peak in the first half of 2009 is commonly explained in relation to the global financial and economic crisis. It not only produces an understanding that Mongolian economy is dependent on external non-resolvable forces, but also raises expectations that the present recession will somehow be resolved as the global crisis recedes.

How justified is this concept can be only proved or rejected by research based on objective statistics and other materials.

To do this, dynamics of main economic indicators and parameters should be analyzed by quarters and half years.

#### 3.1. General index of prices for consumer goods

Fluctuations of prices for consumer goods are the most sensitive indicators of the general economic

situation and market balance. Table 3 shows price indices for 2006-2009.

**Table 3**

Time (year, quarter)		Index compared to the end of 2006	Index compared to the previous quarter
	1	2	3
2007 он	I quarter	1.022	1.022
	II quarter	1.064	1.041
	III quarter	1.126	1.058
	IV quarter	1.151	1.022
2008 он	I quarter	1.247	1.083
	II quarter	1.376	1.104
	III quarter	1.434	1.041
	IV quarter	1.405	0.987
2009 он	I quarter	1.450	1.032
	II quarter	1.385	0.955

It shows that:

1. Regulation of the annual inflation rate maintained at one-digit figure was lost since 2nd to 3d quarters of 2007 and the speed of price growth reached its peak in the third quarter of 2008.
2. In the course of last ten quarters the highest growth of consumer prices was observed in the second quarter of 2008.
3. A trend of declining speed of price growth in the last quarter of the year was repeatedly observed each year.

Causes of such dynamics of changes in prices are well-known. If in second and third quarters of 2007 prices rose following sharp increase in salaries of budget organizations, in the second and third quarters of 2008 expectations of money promised by political parties during parliament elections led to sharp growth of prices.

Trends and the speed of general changes in prices of consumer goods represent in brief changes in prices of different groups and kinds of goods. That is why comparison of the process of changing prices by groups of goods is one of main keys to understand the meaning of the general index. It is shown in table 4.

**Table 4.**

		Consumer basket price index	Of it						
			Food, drinks	Clothes, boots	Housing, water, power, heating	Medicines	Transporta- tion	Education	Hotels, catering
1	2	3	4	5	6	7	8	9	
2006 OH		1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000
2007	I quarter	1.022	1.010	99.8	0.999	1.000	0.988	1.000	1.035
	II quarter	1.064	1.039	100.1	1.002	1.004	1.022	1.000	1.046
	III quarter	1.126	1.186	102.5	1.056	1.115	1.062	1.202	1.126
	IV quarter	1.151	1.246	103.0	1.113	1.142	1.106	1.202	1.140
2008	I quarter	1.247	1.450	104.7	1.125	1.191	1.152	1.202	1.192
	II quarter	1.376	1.721	1.108	1.154	1.383	1.181	1.202	1.332
	III quarter	1.434	1.625	1.138	1.361	1.442	1.508	1.682	1.465
	IV quarter	1.405	1.545	1.200	1.367	1.450	1.391	1.682	1.498
2009	I quarter	1.450	1.649	1.219	1.329	1.483	1.361	1.682	1.529
	II quarter	1.385	1.587	1.204	1.376	1.453	1.393	1.682	1.507



Based on the above structure of main groups of consumer goods following conclusions can be made:

1. Growth of prices for food, drinks and catering constitutes the main share of growing prices for consumer goods.
2. Prices for housing, power and heating as well as fees for services in education sector rise sharply every third quarter of each year, giving an impetus to growth of total prices, but in the end of the year a wave of falling price cycle emerges.
3. A fact that an intensive growth of almost all kinds of goods and services is observed in the second and third quarters every year is one of examples how traders take advantage of events and the psychological atmosphere of the society (holidays, vacations, election etc.)
4. Regulation that maintained price growth within a one digit figure was lost in the most kinds goods and services in the third quarter of 2007, reaching 12.6% in the end of the quarter and

15.1% in the end of the year, which was a reliable sign of unhealthy economy.

5. Growth of prices for goods and services soared in 2008, increasing by 40.5% in the end of the year against 2006, which made a strong impact on the market balance, wealth distribution, consumption structure and dealt a strong blow on living standards of population. When growth of prices in 2006-2009 is examined by groups, it grew by :

- 68.2% - Education services
- 58.7% - Food and drinks
- 50.7% - Hotels and catering
- 39.3% - Medicines
- 37.6% - Housing, power, heating
- 20.4% - Clothing and shoes

### 3.2. Currency rate

Since a great part of consumer goods in our country is imported, the consumer prices are closely connected with the foreign trade prices. Based on this, there is a need for the currency rate

to become an important tool of macro-economic regulation.

Table 5 shows changes in currency rates of two main currencies affecting the market balance in the last quarters since 2006.

**Table 5**

Time		US dollar		Yuan	
		Rate	Seasonal fluctuations%	Rate	Seasonal fluctuations %
1		2	3	4	5
End of 2006		1165.00	-	149.10	-
2007	I quarter	1165.00	0	150.80	+1.14
	II quarter	1163.85	-0.10	150.80	0
	III quarter	1184.26	+1.75	157.61	+4.50
	IV quarter	1169.97	-1.21	160.18	+1.63
2008	I quarter	1168.17	-0.02	166.58	+4.00
	II quarter	1158.12	-0.86	168.78	+1.32
	III quarter	1146.09	-1.04	167.43	-0.80
	IV quarter	1267.51	+10.56	185.25	+10.64
2009	I quarter	1524.07	+20.04	222.95	+20.35
	II quarter	1435.49	-5.84	210.08	-5.77

From the above it can be seen that the US dollar and yuan to tugrug rates fell substantially in the third quarter of 2007, then the tugrug to dollar rate increased in fourth quarter and until fourth quarter 2008 it grew by 3.2%.

However, the tugrug to yuan rate went down steadily. Since fourth quarter of 2008 the tugrug rate fell sharply and in the first quarter of 2009 it reached its peak, compared to 2006 it grew by:

- US dollar 31.6%
- Yuan 50.0%.

Since second quarter of 2009 until present the above currency rate is basically stable. If the tugrug to dollar and yuan rate fluctuations are

matched up to changes in consumer goods prices, interesting dynamics are observed, which is shown in table 6.

**Table 6**

		Index against 2006			Percentage matched to changes in prices	
		Consumer goods prices	US dollar rate	Yuan rate	US dollar rate	Yuan rate
1		2	3	4	5	6
End of 2006		1.000	1.000	1.000	1.000	1.000
2007	I quarter	1.022	1.000	1.011	0.000	0.500
	II quarter	1.064	0.999	1.011	-0.016	0.172
	III quarter	1.126	1.018	1.057	0.143	0.452
	IV quarter	1.151	1.004	1.074	0.026	0.490
2008	I quarter	1.247	1.003	1.117	0.012	0.473
	II quarter	1.376	0.994	1.132	-0.002	0.351
	III quarter	1.434	0.984	1.122	-0.004	0.281
	IV quarter	1.405	1.087	1.242	0.215	0.597
2009	I quarter	1.450	1.308	1.495	0.684	1.100
	II quarter	1.385	1.232	1.409	0.602	1.062

Following conclusions can be made from the above:

1. The tugrug to US dollar rate was completely free of the internal inflation up to the fourth quarter of 2008 and in some cases was subject to the contrary movement, which shows that the Mongol Bank not only lacked sensitivity for macroeconomic regulation, but also did not follow a policy of securing national interests.
2. The tugrug to yuan rate has had a strong positive correlation with inflation. In the first half of 2009 the tugrug to yuan rate exceeded the price growth and fell. It may cause the traders to inflate domestic prices even further. In 2007 and the second quarter of 2008 a trend was observed of the yuan rate lagging behind price growth, which is related to an increasing access to yuan because of supply of cashmere in this period.

3. The dollar and Yuan rates have grown sharply since the fourth quarter of 2008. Artificially maintaining a stable dollar rate, when consumer prices were growing and then creating a sharp shock after the currency reserve, which reached 1019 million US dollars in the end of 2006 declined almost twice, represented a distortion of the monetary policy and became one of reasons for kneeling before the crisis.
4. For our country, that sells its main export products in US dollars, the hard US dollar rate maintained in 2007 and 2008 reduced the domestic industry income by 162 billion tugrugs and 934 billion tugrugs respectively and led to loss of budget income. It became one of causes for decline and recession.

### 3.3. Salaries, wages, pensions and benefits

Budget salaries, social insurance, social insurance pensions and benefits have risen sharply in the last

three years (Table 7).

**Table 7**

*II quarter of 2006 =100*

Indicators	II quarter of 2006	II quarter of 2007	II quarter of 2008	II quarter of 2009
1	2	3	4	5
1. Budget salaries and wages	100.0	132.4	278.5	311.0
1. Social insurance pension	100.0	148.5	228.3	232.2
1. Social welfare pensions and benefits	100.0	211.3	257.9	270.6

This dramatic growth of salaries, pensions and benefits could not leave basic macroeconomic balance as well as currency rates and price growth unaffected. By the second quarter of 2009 the

average monthly salary at national level equaled 309.2 thousand MNT. When the salary levels are examined by professional categories, one can see they are directed to support civil servants.

**Table 8***National average salary = 1.00*

	<b>Men</b>	<b>Women</b>
1 Law-maker, civil servant	1.730	1.370
2 Specialist	1.334	1.157
3 Technical staff	1.217	0.965
4 Assistant clerical staff	0.971	0.792
5 Service staff	0.932	0.732
6 Agriculture, fishery, hunting	0.938	0.780
7 Industry and sales workers	0.944	0.733
8 Machinery and equipment operator, assembly line worker	1.122	0.925
9 Common specialist	0.668	0.651

Of total growth of budget salaries in the last three years 15% is in the second to fourth quarters of 2007, 69% - in the second to fourth quarters, 16% - in the second quarter of 2009. If the structure of social insurance pension growth is studied, 36.6% of it took place in the second quarter of 2007, 60.5% - in 2008, 2.9% - in 2009. This situation illustrates how the state policy drove up inflation.

There is sufficient evidence to view that growth of salaries, pensions and benefits, which passed far ahead of the domestic industry growth, not only drove up price growth, but also affected increase in the import load, disruption of the foreign trade balance, depletion of hard currency reserves (Table 9).

**Table 9**

<b>Indicators</b>	<b>II quarter of 2009 II quarter of 2006</b>	<b>Index compared to growth of budget salaries and wages</b>
1	2	3
Budget salaries and wages	3.11	1.000
1 Industrial produce (adjacent prices)	2.002	0.61
2 Construction works (prices of the year)	1.445	0.465
3 Reared young livestock	1.367	0.439
4 Sown area	1.796	0.577
5 Import	1.445	0.464

According to the statistical data, while in the first half of 2006 sale of industrial produce (prices of the year) equaled 889.7 billion MNT, in 2007 it rose by 27.2%, in 2008- by 28.7%, but in the first half of 2009 it fell by 23.8%. It is well-known that growth of sales income in the two previous years was related to growing export prices for precious

and non-ferrous metals. In this way measures taken by the state in the last three years on increasing salaries, pensions and benefits were not secured by material wealth, so there are grounds to view that in this aspect they affected the macroeconomic crisis.

### 3.4. Money, loans

It can be viewed that crisis in the dynamics of our economy in the last three years in many aspects is

connected with money supply and a policy on its structure. Table 10 illustrates it.

**Table 10**

		Total money $M_2$	$M_1$	Of it	
				Money outside banks	Current account balance
1.	Billion MNT				
	2006 on IV quarter	1536.5	331.9	185.1	146.7
	2007 II quarter	2016.1	502.2	262.4	239.8
	IV quarter	2401.9	590.5	283.3	307.1
	2008 II quarter	2564.7	628.9	307.8	317.1
	IV quarter	2270.0	647.3	328.7	318.6
	2009 II quarter	2424.6	534.3	283.8	250.5
2.	2006 = 100%,	100.0	100.0	100.0	100.0
	2007 II quarter	136.1	151.2	141.6	163.7
	IV quarter	156.3	178.2	152.9	2.102
	2008 II quarter	166.9	189.7	165.9	2.170
	IV quarter	147.8	195.5	177.3	2.178
	2007 II quarter	157.8	161.3	152.9	1.710

It shows that in the last three years money supply has been fluctuating abruptly, so 63.3% of money growth in 2006 - 2009 took place in the second term of 2007 with 83.5% of  $M_1$  growth and 89.7% of current account balance growth in the same quarter.

Since third quarter of 2008 the monetary policy of the Central Bank has changed abruptly and in the second quarter of 2009 compared to the same

period of 2008, total money,  $M_1$ , money outside banks, current accounts balance in MNT fell down by 5.5%, 15.1%, 8.1% and 21.1% respectively. In the same period quasi-money (time savings + currency savings) decreased by 2.5%, basically remaining at the same level.

Following statistics show that such a monetary supply policy conflicts with the objective economic needs (Table 11).

**Table 11**

*(billion MNT)*

	2006	2007	2008	2009
1	2	3	4	5
1 GDP by prices of the year	3714.9	4557.5	6130.3	7050*
2 Total money - $M_2$	1536.5	2401.9	2270	2424.6
3 Number of money turnover	2.42	1.90	2.70	2.91
4 Growth of budget salaries 2006 = 100	100.0	132.4	278.5	311.0
5 Growth of money outside banks 2006 = 100	100.0	152.9	177.3	152.9
6 Ratio of Growth of money outside banks to Growth of budget salaries	1.000	1.155	0.638	0.492

\* Author's calculations

It shows that in 2007 money supply bypassed GDP turnover, reducing the speed of money turnover by 21.5% and since the end of 2008 an abrupt policy of folding up money was introduced, thus increasing the turnover demand by 42% and lodging the economy in a jam.

Furthermore, supply of Money outside banks, which was ahead of growth of budget salaries by 15.5% in 2007, lagged behind by 36.2% in the end of 2008, and by 51.8% in the first half of 2009, which is related to ever-declining income of especially rural population, but in total becomes a prerequisite of deflation.

Of total money in our country 2/3 are quasi-money. Substantial changes took place in the

dynamics and purchasing power of quasi-money in the last three years. (Table 12)

**Table 12**

	Quasi money (billion MNT)	2006 = 100	US dollar rate (tug)	Quasi money million (US dollar)	2006 = 100
1	2	3	4	5	6
2006	1204.6	100.0	1165	1033.4	100.0
2007 II quarter	1513.9	125.6	1164	1299.8	125.7
IV quarter	1810.8	150.3	1170	1547.2	149.5
2008 II quarter	1939.8	161.0	1158	1674.4	162.1
IV quarter	1622.7	134.7	1267	1280.1	123.9
2009 II quarter	1890.3	156.9	1435	1317.1	127.5

While in the end of 2006 total currency reserves reached 1019 million US dollars, in the beginning of 2009 they went down to 500 million dollars, which weakened greatly the ability of quasi-money

to service the economic demand as we mentioned previously.

As the previous table 12 shows, growth of quasi-money has been quite different from the GDP dynamics (Table 13).

**Table 13**

	GDP (price of the year billion MNT)	2006 = 100	Quasi money (billion MNT)	2006 = 100
2006	3714	100.0	1204.9	100.0
2007 II quarter	-	-	1513.9	125.7
IV quarter	4557	122.7	1810.8	150.3
2008 II quarter	-	-	1939.8	161.5
IV quarter	6130	165.1	1622.7	134.7
2009 II quarter	-	-	1890.4	157.5
IV quarter	7050*	189.8*	2000.0*	166.1

\* Author's projection



In the past years since mid-2007 growth of quasi-money increased twice faster than GDP turnover, but since the end of 2008 it lagged behind it. It illustrates that the state monetary policy is short-sighted and is not researched thoroughly.

The bank loans and loan interest policy had the hardest situation in the last three years. Table 14 shows dynamics of total loans outstanding and their structure.

**Table 14**

	Total loans outstanding		Past due loans		Non-performing loans	
	Billion MNT	2006 = 100	Billion MNT	2006 = 100	Billion MNT	2006 = 100
1	2	3	4	5	6	7
2006	1223.3	100.0	33.3	100.0	60.0	100.0
2007 II quarter	1600.2	130.8	44.7	134.2	61.9	103.2
IV quarter	2056.1	168.1	40.3	121.0	68.1	113.5
2008 II quarter	2559.4	209.2	54.6	164.0	73.0	121.7
IV quarter	2635.6	215.4	93.3	280.2	188.7	314.5
2009 II quarter	2558.9	209.2	152.1	456.8	298.0	496.7

Following peculiarities can be observed from the above:

1. In the last 3 years the loans outstanding have exceeded the GDP growth, however, since the beginning of 2007 to the end of the first half of 2008 in the course of one year and half it increased 2.1 times against the first balance of 2007. It proves that the loan policy was too weak.

It is well known that the main cause of this loan “mania” was the year of “great

development” announced by the government of Mongolia in 2007-2008, which led to inflation of prices for housing by the chain of foreign and domestic construction companies and artificial expansion of construction industry regardless of lack of construction materials and technical capacity as well as shortage of qualified workers.

2. The volume of past due, non-performing loans increased steadily, soaring in the last half of 2008. This was related to the quality and justification of previous loans. Therefore, short-

sighted banks became alarmed only in the 4th quarter of 2008, which was too late.

Non-performing and past due loans or bad loans reached 17.5% of total loans in the first half of 2009 and their number is continuing to grow. By the first half of 2009, the construction sector accounted for 21.1% of total loans outstanding. At present (second quarter) bad loans reached 96.6% of total bank reserves. This situation shows that the economic recession in our country is not only continuing, but signals that there is a stronger blow to come.

3. In present conditions, when the loans outstanding are not decreasing and the quality of loans is weakening along with strong economic decline, the government savings of

540.7 billion MNT allocated in banks reached 15.0% of total bank liabilities and became a main source of support for banks. However, this mechanism cannot last for long. The time will come, when the state loan policy supports the economic overhaul and through will direct banks towards cure.

4. In the fourth quarter of 2008, when the economic crisis was at its highest point, the Mongol Bank increased its policy interest to 52% and although it reduced the interest rate in July and September, the interest rate is still 21% higher compared to that of mid-2008. This policy blocked the loan turnover and strangled the economy. It can be seen from the loan flow in the last one year (Table 16).

**Table 16**

*(billion MNT)*

		<b>Loans outstanding</b>		<b>2009.VI</b>
		2008.VI	2009.VI	2008. VI
Total		2559.4	2558.9	0.997
Of it:	Golomt	419.1	435.8	1.033
	Capital	48.8	53.6	1.098
	KHAAN	588.5	562.9	0.956
	TDB	453.3	416.0	0.918
	Mongol Post	179.2	140.7	0.785
	Savings	51.5	52.1	1.009
	Transport and development	8.8	9.1	1.034

Table 16 (cont.)

Erel	9.5	8.7	0.915
Credit	4.5	4.6	1.022
Ulaanbaatar	122.4	125.9	1.028
Zoos	167.4	191.8	1.145
Anod	179.2	170.9	0.954
Capitron	84.4	90.9	1.087
Khas	136.5	162.2	1.197
Chinghis Khaan	86.7	107.9	1.259

A fact that the banking sector got into such a difficult, stagnant state will deepen further losses and increase risks. In 2008 the Parliament made a decision to secure individual savings by the state. It is not a savings insurance. If banks face bankruptcy as the Anod bank, the state will not be able to bear the savings risks.

Individual savings account for 34.2% of total loans outstanding in banks. It equals to 27-30% of their annual cash income. However, while banks pay 0.4-1% for deposits and 0.2-1.5% for time deposits, their loan interests is 1-4%.

It can be seen that in present conditions banks survive by lending money to the public rather than serving the real economy with turnover of money.

### 3.5. Foreign trade, prices

The present economic recession in Mongolia stems from the global financial and economic crisis and there is a widespread understanding in the society that with stabilization and growth of prices for copper, gold, raw materials, the crisis in our country will go away.

A look at the 2003-2009 foreign trade turnover statistics shows that it is necessary to address the above problem carefully (Table 17).

**Table 17**

		Transactions in the first half of the year				2007	2008
		2006	2007	2008	2009		
1		2	3	4	5	6	7
1	Export						
	- mil US dollar	611.6	836.2	1276.3	762.9	1889.0	2539.3
	- 2006 = 100	100.0	136.7	208.7	124.7	-	-
2.	Import						
	- mil US dollar	617.2	868.4	1695.0	892.8	2117.3	3615.8
	- 2006 = 100	100.0	140.7	274.6	144.6	-	-
3.	Foreign trade balance						
	- mil US dollar	-5.6	-31.8	-418.7	-129.9	-228.3	-1076.5
	- 2006 = 100	100.0	567.9	75 times	23 times	-	-
	In export, by %	-0.9	-3.8	-32.8	-17.0	-12.1	-42.3

Following conclusions can be made based on these statistics:

1. Until the end of 2008 the global economic situation did not affect significantly the export income of our country. If in the first half of 2008 the export income rose by 52.6 % compared to the same period of 2007, in the last half it grew by 20.0%.
2. The foreign trade balance that was stable in 2006 and the first half of 2007 fell down sharply since the last half of 2007. The volume of import increased by 43.8 % in the last half

of 2007 compared to the first half of the same year and in the first half of 2008 it rose by 95.2%. It showed an import mania caused by the “great development” policy. The foreign trade balance losses increased 5.7 times in 2007, 75 times in 2008 and 23 times in 2009 compared to the first half of 2006.

3. The global economic crisis affected our country significantly since 2009. It was related to strong fluctuations of prices for basic metals at the global market and reduced demand for them (Table 18).

**Table 18**

	Price per 1 ton /US dollar			2007 = 100	
	2007	2008	2009	2008	2009
1	2	3	4	5	6
Gold (1 ton = mil \$)	20.25	27.1	27.3	133.8	134.8
Copper concentrate	1235.1	1433.5	654.2	107.3	49.00
Zinc concentrate	1326.1	1128.5	676.3	85.1	51.0

The sales price for gold did not fall, but prices for copper and zinc concentrate decreased twice. It definitely affected decline of export income.

problems in our economy. This understanding should be treated cautiously. The dynamics of petrol and diesel fuel prices in 2007 – 2009 is shown in table 19.

4. It is widely understood that sharp rise of petrol prices at the global market in 2008 caused great

**Table 19**

	Price per ton/US dollars			2007 = 100	
	2007	2008	2009	2008	2009
1	2	3	4	5	6
1. Petrol for vehicles	690.7	988.3	504.8	143.1	73.1
2. Diesel fuel	698.2	1092.5	592.8	156.4	84.7

Although the price of fuel rose by 43.1- 56.4% in 2008 against the previous year, it was by 15.3-26.9% cheaper in the first half of 2009 against 2007 and by 45.7- 49.0% lower against 2008.

In 2008, when prices for main export products of our country grew sharply, growth of fuel

prices was not a cause for crisis, but only an issue of domestic regulation. In 2009 prices for some export products went down and the fuel price also went down. This is not a cause for recession that becomes chronic. If the first half of 2009 is compared to the same period of 2008, our economy lost 225.9 million US dollars due to fall of copper prices, but gained

154.5 million USD from decreasing fuel prices. The gap of 71.4 million dollars equals 9.4% of export income, which is a possible fluctuation in normal conditions.

1. Sharp rise in fuel prices in 2008 increased the petrol import of our country by 6% and that of diesel fuel by 10.8%, this year, when the prices fell, petrol and diesel fuel were imported less by 23% and 14.2% respectively, which is related to implementation of the state policy on increasing national reserves at the peak of growing prices for petrol last year.

If the dynamics of the first half of 2009 continue throughout the year, all economic sectors except for agriculture (livestock breeding and crop cultivation) are heading towards decline by 7.2-38.2%. Export declined by 30%. Although decline in foreign currency reserves might be compensated by reduction of import, it will, in return, be connected to domestic market, production and consumption decline.

Along with this further worsening of banking and finance situation each quarter causes even more difficulties for a possibility of economic recovery.

In the first seven months of 2009 the export income decreased by 539.9 million US dollars compared to the same period of the last year. Of it price reduction accounts for 85.7% or 462.5 million US dollars, and reduced production of goods accounts for 14.3% or 77.4 million US dollars. Among products, which prices went down, the copper concentrate takes a special place and in the first 7 months 335.3 thousand tons of concentrate were sold at 683 US dollars per ton, so income was by 291.7 million dollars less against the last year.

In the above period purified copper and copper alloy were sold at the average price of 4020 dollars per ton. Even if copper prices reach 6000 dollars in the last half of the year, it will not compensate 2/3 of the above mentioned loss. It is almost certain that loss of 150 million dollars due to declining prices for molybdenum, zinc and petrol will not be compensated.

### 3.6. Some production dynamics

Since 2006 the national domestic product of Mongolia has increased by 8.6-9.9% annually. According to the NSO calculations, in 2009 it is to reduce by 1.3%. The NSO based its calculations on the hard prices of 2005. If decline of income in hard currency due to prices of export products is

taken into account, NDP in 2009 will decline by 11.1-13.0% of the real volume of the last year.

By the first half of 2009 main industrial sectors have following dynamics (Table 20).

**Table 20**

	First half			2007, II = 100		2009 2008
	2007	2008	2009	2008	2009	
1	2	3	4	5	6	7
1 Industrial output (2005 prices)- billion MNT	770.5	799.9	742.9	103.8	96.4	92.8
2 Construction (prices of the year)- billion MNT	68.4	108.2	66.9	158.1	97.8	61.8
3 Reared young livestock (million heads)	11.9	12.1	13.6	101.7	114.3	112.4
4 Sown area (thou.hectares)	195.8	190.3	280.3	97.2	143.1	147.3
5 Wholesale (mil. MNT)	165.5	319.2	273.1	192.9	165.5	85.5
6 Retail trade (mil. MNT)	156.4	254.9	181.1	162.9	115.7	71.2
7 Export (mil. US dollars)	836.2	1276.3	892.8	152.6	106.8	70.0

## 4. THIRD QUARTER OF 2009

Such institutions as our NDIC made a conclusion that since July 2009 the economic crisis went away and the recovery began.

If we look at the NSO data on the third quarter of 2009, following dynamics are observed against last year ( Table 21).

**Table 21**

Indicators	Changes in percent (%)	
	2009 I – III 2008 I – III	2009 III 2008 III
1	2	3
1. Consumer price index	-0.1	-2.7
2. Budget salaries and wages	+9.4	+4.1
3. Pensions and benefits	+2.1	2.1
4. Labor productivity in industry	-5.5	-9.7
5. State budget income	-17.8	-13.8
6. State budget expenditure	+2.6	-1.4
Of it: current expenses	+2.8	+3.3
7. Total money	+5.1	+5.1
8. Total loans	-3.2	-54.3
Of it: non-performing loans	5.29 дахин	47.5 дахин
9. Export	-33.9	-22.2
10. Import	-38.8	-19.0
11. Industrial output (2005 prices)	-10.6	-16.3
12. Construction works	-31.5	-24.6
13. Harvested crops	+59.9	+59.9
14. Harvested vegetables	+28.6	+28.6



This statistics show that it is too early to make a conclusion that the national economic crisis ended and recovery started, and risks of facing chronic problems are increasing even more. There are objective grounds for such caution:

1. Production in all sectors except agriculture has not grown, but declined against the last year. By the first 9 months results the industrial output was 10.6% less against the previous year and in the third quarter there was a 16.3% decline. Labor productivity in industry decreased by 5.5% in the first 9 months with 9.7% decline in the third quarter.
2. The volume of export and import is 33.9-38.8% less compared to the level of first nine months of the last year.
3. The state budget income declined by 17.8% in the first nine months with 13.8% reduction in the first quarter, while the current budget expenditure increased by 2.8% in the first nine months and by 3.3% in the third quarter.

4. The amount of total money grew up by 5.1%, of it money from outside banks- by 0.7%. In the above period the budget salaries and pensions and benefits rose by 9.4 and 2.1% respectively, so the above figure of money supply represents continuing consumer market crisis.
5. The bank loan turnover has slowed down perceptively and the situation in this sphere has become quite problematic.

If the first 3 quarters of 2009 are compared to those of the last year the loans outstanding declined by 4.2% and in the third quarter growth of loans outstanding declined by 54.3%. However, the non-performing loans outstanding grew 5.29 times in the first 9 months and in the third quarter they grew 47.5 times. Problems that have accumulated in the banking sector are illustrated in the following Table 22.

Table 22

	2008		2009		$\frac{2009}{2008}$	- %
	June	September	June	September	June	September
1	2	3	4	5	6	7
1. Total bank assets (liabilities)- billion MNT. Of it:	3281.3	3427.4	3603.7	3814.7	109.8	111.3
- Central Bank securities	63.3	41.1	143.9	356.7	227.3	867.9
- Bank reserves	198.4	229.6	466.0	376.6	235.3	164.0
- Equity	426.6	479.8	323.4	249.8	75.8	52.1
2. Total assets (liabilities)=100	100.0	100.0	100.0	100.0	-	-
- Central Bank securities	0.19	1.2	4.0	9.3	-	-
- Bank reserves	6.0	6.7	12.9	9.8	-	-
- Equity	13.0	14.0	8.98	6.5	-	-
3. Total loans outstanding – billion MNT	2559.4	2716.8	2558.9	2630.9	99.98	96.8
- Past due	54.6	54.8	152.1	198.2	278.5	361.7
- Non-performing	73.1	75.1	297.9	397.7	407.5	529.6
4. Total loans = 100	100.0	100.0	100.0	100.0	-	-
Of it						
- Past due	2.1	2.0	5.9	7.5	-	-
- Non-performing	2.8	2.8	11.6	15.1	-	-

The crisis faced by the banking sector is represented by the following symptoms.

1. While the share of equity in total bank liabilities equaled 14% in the third quarter of 2008, it declined to 6.5 in third quarter of 2009 and the total money went down by 47.1% in the same period. The situation in banking became unstable.

2. While the Central bank securities in total bank assets accounted for 1.2% in the third quarter of 2008, in the third quarter of 2009 it grew to 9.8%. Independence and free opportunities for activities of commercial banks has become limited.
3. In one year the bank reserves increased 2.3 times and its share in total assets increased 2.2

times. It illustrates weakening money turnover and expectations of risks.

4. The volume of total loans reduced by 3.2% compared to the third quarter of 2008, but the past due loans and non-performing loans increased 3.6 and 5.3 times respectively. While in the end of the third quarter of 2008 past due loans accounted for 2.0% of total loans, at present it grew to 7.5%, non-performing loans increased from 2.8 to 15.1% and bad loans account for 22.6% of total loans. When

the third quarter of 2009 is compared to the second quarter, past due loans and non performing loans grew by 30.3 and 33.5% respectively.

To sum up, the banking sector came to the brink of an acute crisis and it cannot avoid it without a very strong support from the government. It is time for the government to pay attention to the fact that a catastrophe in the banking sector will lead to a strong economic as well as social crisis.

## 5. CONCLUSIONS AND LESSONS FROM THE LAST THREE YEARS

For the first time in its history Mongolia faced a crisis of the market economic system and was swept by the wave of global financial crisis. Politicians, economists and businessman do not agree on the ways to getting out of crisis and its consequences.

As the above study of economic statistics in our country shows, the economic crisis faced at present is a sum of two consequent crises and contains double blows. For instance:

1. Since mid-2007 due to mistaken, weak policy of our government the crisis of domestic “manufacture” started and reached its peak in the middle of 2008. This is proved by rising inflation and loss of macro-economic

balance since mid 2007 and problems with the monetary and loan policies in 2008. At that time the government announced “Great development”, conducted a universal, “soft” social policy and misused favorable conditions at the global market.

2. At the time, when the crisis of “manufacture” caused by internal sectors reached its peak with inflation exceeding 34% and the foreign trade deficit of 23.9% with loss of budget balance, the global financial and economic crisis took place and dealt a knock-out blow.

At present our country needs to resolve the problem of whether the above double crisis in economy will lead to failure of the banking sector.

Since the start of crisis in the period of over one year or until the end of 2008 public institutions did not take any measures to improve the economic policy, but, on the contrary, supported ineffective investment, thus strengthening the tugrik rate, and put forward nice development slogans. Even in the fourth quarter of 2008, when the global economic crisis started, the state approved a budget with enormous loss and there was even talk about opportunities to gain from crisis. In the last quarter of 2008, when the situation became hopeless, the government and the parliament made a decision to secure savings of the general public (in reality they remained without any guarantee) and the Mongol bank increased sharply its policy interests. No other measures were taken.

In the beginning of 2009 the government presented a plan to overcome crisis for approval by the parliament. The core of the plan is to take a loan equal to 1500 billion MNT from foreign countries to support national economy. The government did not realize that the Mongolian economy has a united, interrelated system, although it is small-scale and open. At present the loan of 1500 million dollars is not secured and the only hope is on some loans from the IFM and donors to sustain the economy. Although a fall in consumer prices observed in the last months is promoted as a proof of getting out of crisis, it looks more like deflation caused by spreading crisis. While in the third quarter of this year retails prices declined by 28.8%, wholesale- by 30% and import- by 38.8% compared to the same

quarter of the last year, decreasing prices can only present deflation.

The greatest impact of the global financial and economic crisis on the economy of our country is falling demand for minerals at the global market and declining prices for them. This is a common destiny for economies based on raw materials, following the direction of mining. In other words, it is the consequence of Dutch disease that has already affected our economy.

The present economic crisis that greatly harmed the future of our country as well as the lives of the people taught severe lessons to the Mongolian state policy:

1. If the economic policy, its directions and methods adopted by the Mongolian state (Parliament, GoM) does not reach the level of modern global insight and atmosphere, the economy of our country cannot become healthy. Since 2000 the political parties, fighting for power and authority, have made promises that exceed the capacity of our national economy and in 2008 elections the economy was used at the level of a political pawn, a scapegoat. Since mid-2007 the highest state institutions followed populist policies directed towards 2008 parliament and local elections. They confused the starting positive market cycle with a sustainable trend, which started the “manufacture” crisis.

In the conditions of deepening economic recession along with reverberation of the global economic crisis the present parliament and the government proved their inability to conduct a sound policy. The banking, financial and monetary policies failed and at least 500 billion from taxpayers money and loans from abroad that the next generation will have to pay back is needed for economic recovery.

At each level of a state institution professionals capable to perform their duties should work. However, the economic policy planned and implemented by the present parliament and government is at the level of the “small traders concept”, which should be changed.

2. The present state system itself limits opportunities for implementation of a proper, justified, controlled economic policy. Since 2000, when candidates to the parliament started competing with each other with their wealth in the course of election, making any promises that their mouths could utter in order to become parliament members and then becoming ministers without any idea about the state policy, a conflict of interests between the state policy and business became obvious and it became “a performance of volunteer actors” by non-professional ministers. The policy of “great development” announced in 2007 and continued in 2008 also was of the same nature. As a result, 1/3 of total money to service the national economy is blocked in unfinished housing construction. The attempt to secure

aid and loans from foreign countries in 2009 was of the same nature.

The monetary and loan policy of the Mongol bank up to the present was also of the same nature. It is time to clarify responsibilities of the parliament and the government.

3. A fact that a state policy based on politics and business union leads to bankruptcy became obvious during this crisis. That this connection is one of the main root causes of problems faced by the banks becomes more obvious everyday. While in rural areas prices for livestock and raw materials have fallen down sharply and herders’ livelihoods have declined, this summer in urban areas prices for meat rose sharply, which represented one of harmful consequences of this connection. Although prices for fuel, energy that affect basic prices of the market economy have grown year by year, becoming a heavy load for the economy, the government did not take any proper measures to overcome this. Everyone knows that many mining companies conduct their activities without any control from the state causing irreparable damage to the economy and environment.

The state budget planning and implementation in the last 3 years clearly showed that a state policy based on the union of politics and business is not able to save money or effectively spend it.

Although many years ago professionals started warning that behind each article of the budget expenditure there was an interest of a certain business group and the national economy has become a “distribution economy” looking for the budget, the state did not listen to them. At the present time of economic crisis and historic challenge a need to increase the sensitivity of state policy has become urgent.

4. A lesson that an economy with a one-sided structure, based on raw materials becomes a pawn of market conditions even in conditions of a market with few kinds of raw materials let alone a global crisis, was taught by the present crisis. Attracting foreign and domestic investment in mining of minerals and their export in order to follow further extensive economic growth policy will inevitably make the economy even more vulnerable.
5. Another lesson learned from crisis is that the state should have different policy options for overcoming various directions of economic crisis, as well as assets and resources. If income derived from the growth of raw materials export in 2006-2008 was properly accumulated and utilized, there was an opportunity to overcome the present crisis easily. However, it was spent ineffectively on the initiative of the highest state institutions, which became an impetus for the crisis. It is

time to stop a possibility of repeating such a mistake.

6. Incomprehensive macroeconomic, financial, monetary and loan policies, lack of links between them augments the strength of crisis and makes it chronic. This chaotic situation caused the start of the present crisis and makes its end more difficult. Although in the frame of the parliament such coordination of the state policy should be made, the course of 2008-2009 session clearly showed lack of the structure to meet this need and inability of Standing committees to coordinate and focus their activities.

Instead of formulating the policy at the level of the highest state institution the parliament has become a place of trade-off for political parties, results of which are forced to be accepted by the society, which was revealed in the course of discussing all problems related to the present crisis. It is time for the Mongolian state to implement a unified economic policy.

7. Increasing the capacity of banks to carry the load at the time of economic crisis with a wide frame, supporting conditions for proper activities has become a focus of the state policy that does not exist at present. At the start of the present crisis, the state promised to guarantee savings of population,

which calmed the people, but it was a false, misleading promise. It might lead the banks to taking wrong steps and furthermore, the state compensates the loss caused by irresponsible activities with money of taxpayers and provides loan-takers, who caused the bank bankruptcy, with an opportunity to take an advantage of it. The bank immunity should be implemented in a relation to the savings insurance. It is a time to realize that a strong state control is necessary to provide security of bank transactions.

8. Herders are a social group that were hit the hardest by the present crisis. Their income fell, while consumer prices have increased. The state policy concerning herders at that time was directed towards support of their wealthiest part. Furthermore, support of only the goat-breeding led the livestock to even more

vulnerable state. There is lack of a unified system with regular operations to protect herders' livelihood from market fluctuations and sudden climatic changes and to ensure the sustainability of livestock breeding. Without resolving that problem the national economy cannot be stabilized.

9. One of the main causes of the present economic crisis in our country was fluctuations in prices for petrol at the global market. There is lack of the state policy to provide the country with its own fuel. The present petrol importers will not support such a policy and will not be able to implement it.

The above few lessons cannot cover the whole frame of the crisis. However, I hope that it might be helpful for the first steps in this direction.

